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Statement by the Staff Representative on
Preliminary Considerations Regarding
Fund Support for Debt Reduction Operations
Executive Board Informal Session
May 5, 1989

The staff paper "Fund Support for Debt Reduction Operations--Preliminary Considerations" (EBS/89/78, 4/19/89) outlines the main issues and possible approaches for Fund support of debt reduction 1/, following on the agreement by the Interim Committee that the Fund should provide resources to facilitate such operations for members undertaking sound economic reforms. The purpose of the present statement is to indicate the staff's further thoughts on these issues with a view to allowing an early start to be made.

There has been considerable diversity of experience in the debt reduction operations that have been undertaken so far by countries. In most cases, the Fund's assessment of the member's reserves, balance of payments, and domestic macro targets provided a framework within which to evaluate the impact of debt reduction operations. In some cases, program targets and performance criteria were adjusted to reflect the impact of these operations. As the next phase of the debt strategy evolves, the Fund should continue to perform this role for members, financial institutions, and official institutions.

Substantial uncertainties remain regarding debt reduction operations--including in particular their pricing and structure, the timing of their impact on countries' balance of payments needs, and their implications for economic growth and the design of programs. These considerations underline the importance of addressing countries' needs on a case-by-case basis and avoiding the setting of rigid rules that could prove difficult to operate. In addition, it would be undesirable if new official efforts to support debt reduction interrupted debt reduction programs and instruments already in progress.

Formalization of procedures for providing Fund support of debt operations could lead to pressures for a new facility for this purpose, causing delays, and unwarranted and rigid linkages between the use of Fund resources and a member's relations with banks and other creditors. Moreover, the kinds of guidelines that might become necessary if Fund support were directly tied to particular financing

1/ The term debt reduction encompasses debt service reduction as well as principal reduction. Some specific techniques of debt reduction may involve a combination of principal and interest reduction.

operations could involve the Fund inappropriately in negotiations properly to be conducted between member countries and their creditor banks on a voluntary market basis.

Experience has confirmed the importance of ease and efficiency of operations, and it is therefore preferable that the procedures for Fund assistance for general balance of payments support, whatever its precise objective, not be unduly rigid and complex. Moreover, for Fund support to contribute effectively to balance of payments viability, it is essential that prime emphasis continue to be placed on the needed economic adjustment in borrowing countries. These considerations suggest that assistance given by the Fund for debt reduction be provided through stand-by and extended arrangements and linked to program performance; in some cases, frontloading of purchases may be appropriate.

At the same time, provisions will need to be made in such Fund arrangements to provide a clear indication of the Fund's support for debt reduction and to ensure that the resources are used appropriately for debt reduction operations. Program targets, including the net international reserves target, could be designed to accommodate the use of the set-aside part of Fund access for debt reduction operations. As a corollary, programs could be designed and reviews conducted in a way that would ensure that resources made available for debt reduction are used for such operations, or kept in reserves or a special account.

Prudence would suggest that disbursements of Fund resources for the set-aside should only take place after the Board was assured that the member's debt reduction program was consistent with substantial progress toward external viability. When requesting an arrangement with a set-aside, the authorities would indicate their intention to seek official support to carry out debt reduction operations, using the resources made available to them as efficiently as possible to secure effective debt reduction. Disbursements could begin from the start of the arrangement if it were possible at that time for the authorities to provide a general description of their plans for debt reduction and the modalities of financing procedures, while of course not divulging market-sensitive information. Otherwise, the member's rights to purchase the set-aside amounts would accumulate in line with program performance, and be released during the program period provided that the program remained on track when the Board had been satisfied with the outline of the member's debt reduction plan.

In addition to the usual information provided to the Fund concerning debt reduction operations conducted during a Fund arrangement (or information provided at the time of an Article IV consultation), the authorities will provide the Fund with detailed information on debt reduction operations involving the use of Fund (and other official) resources as they take place. There will also be a need for periodic reviews of arrangements to consider how debt reduction operations are developing and how Fund and other official resources are contributing or

could contribute to the process of effective debt reduction. On these occasions the Board would have the opportunity to reconsider the modalities of continued Fund support for the country's debt reduction operations, including possible changes in monitoring.

In setting aside part of its general balance of payments support for debt reduction, the Fund would probably want to be cautious, taking into account the member's other balance of payments requirements. A figure of 25 percent of access under the arrangement has been suggested and initial operations could go ahead with set-asides of around this size; the precise proportion for each country would be decided on a case-by-case basis. If a country was able to agree on a substantial debt reduction operation that would offer the promise of a major improvement in its debt situation, and additional Fund support would be decisive in facilitating such an operation, consideration could be given to increasing the member's access to Fund resources. It should be possible to use such additional resources, which it has been suggested might be up to 40 percent of quota, to support a variety of debt-reduction techniques that would reduce permanently the country's debt burden; these could include the establishment of a special account to secure debt service payments on new debt instruments if this were appropriate.

It would generally be expected that when debt reduction is important, the World Bank would be actively involved in supporting such operations. The two institutions would be expected to remain in close consultation along the lines envisaged in the recent Board paper on Bank-Fund collaboration in assisting member countries. If the Bank were reluctant to participate, and this reflected serious policy weaknesses of the member in key structural areas, the Fund would have cause for concern and might decide to await agreement between the Bank and the member. The views of the one institution on a member's debt reduction program involving the use of Fund or Bank resources will in each case be made known to the other institution.

The approach outlined here could be developed in country cases as they come forward to the Board in the coming weeks. The broader policy issues involved in the implementation of Fund support for debt reduction operations could be reviewed in light of this experience.